
The Next CFPB Regulatory Challenge: Small Business Lending

By Joann Needleman, Jane C. Luxton, Thomas A. Brooks / May 12, 2017

The Consumer Financial Protection Bureau (CFPB or Bureau) has launched a series of initiatives signaling that small business lending will be its next top priority.

Under 12 U.S.C. § 5481(12) of the Dodd-Frank Act, the CFPB has authority over enumerated federal consumer protection laws including but not limited to the Equal Credit Opportunity Act (ECOA). More specifically, Congress amended ECOA, 15 U.S.C. 1691c-2, (Section 1071 of the Dodd-Frank Act) to specifically authorize the Bureau to collect data on small-business lending in an effort to "facilitate enforcement of fair lending laws and enable communities, governmental entities, and creditors to identify business and community development needs and opportunities of women-owned, minority-owned, and small businesses."

On May 10, 2017, the CFPB issued a Request for Information (RFI) in order to gain a better understanding of the small business lending industry, especially as it relates to data collection. The Bureau stated that it is exploring the following topics:

- What defines a small business;
- What institutions lend to small businesses and what products are offered;
- What types of business lending information are used by financial institutions; and
- Privacy impact of the public release of small business lending data.

In addition to the RFI, the CFPB also released a white paper that reflected the initial findings of the Bureau's research on the small business lending market, with a particular emphasis on women-owned and minority-owned businesses. The preliminary conclusions set forth in the white paper are as follows:

- Small businesses play a vital role in the U.S. economy, and access to credit is crucial to ensure their business cash flows smoothly from current operations and to allow entrepreneurs to take advantage of opportunities for growth; and
- Data on how small businesses engage in the credit marketplace are limited in several ways and incomplete.

In coordination with the publication of the RFI and white paper, the Bureau held a field hearing in Los Angeles on May 10, 2017, to discuss these issues. All these actions are initial steps in the Bureau's attempt to craft a rule setting forth requirements for the collection and reporting of lending data.

Industry has been anticipating the CFPB's actions. The Bureau has made several moves in the last year which signaled that fair lending in the small business lending market was next on its agenda. In April 2016, Grady Hedgespeth joined the CFPB as Assistant Director for the Office of Small Business Lending Markets. Prior to joining the Bureau, Mr. Hedgespeth served as the Director of the Office of Economic Opportunity for the U.S. Small Business Administration. The Bureau has also conducted a number of ECOA supervisory examinations of small business lending programs at various financial institutions.

Small, mid-size and regional banks could see the most significant impact from the CFPB's proposals. Based on the Bureau's research, 46% of the small businesses that were surveyed applied for credit at a small bank. Of those that applied, the percentage of approval was higher at small banks than at larger banks. Testimony at the field hearing also suggests that there is an increasing tendency for small businesses to use alternative sources of funding, such as online lenders like Kabbage and On Deck, as well as marketplace and even payday lenders.

It is no coincidence that the field hearing took place in California, given Silicon Valley's predominance in the online lending space. Further, California's Department of Business Oversight (DBO) has been extremely active in its oversight of the alternative and online sector. In April 2016, the DBO issued a report of data collected regarding the business transactions of 13 online lenders both nationally and state-wide. DBO's data summary showed that small business financing transactions increased by 629.5% nationally to \$2.94 billion during the four year period between 2010 through 2014. These same online lenders have raised concerns about the increased regulatory burden and the potential hurdles that might result from enhanced data collection requirements. Whether these institutions currently have the necessary infrastructure to collect required data is unclear.

Regardless, the time is now for small, mid-size and regional banks as well as non-bank financial institutions to assess their small business underwriting programs for compliance not only with ECOA but to ensure these programs do not otherwise conflict with any other state lending or securities laws. The CFPB has repeatedly stepped up enforcement activity in advance of proposing new rules, and lenders in this market sector would be well-advised to increase their vigilance on all compliance obligations.

Other Considerations

SBREFA. As the CFPB moves forward in developing this rule, there is little question it will have to convene a panel required by the Small Business Regulatory Enforcement Fairness Act (SBREFA), to examine the regulatory burden it will impose upon small business financial service providers and ways to ameliorate the costs of new data collection and reporting obligations. Under the Dodd-Frank Act, the CFPB is one of three agencies required to insert an extra step at the beginning of rulemakings that have a significant impact on a substantial number of small entities. Director Cordray's prepared remarks note the similarities between the forthcoming rule and the 2015 CFPB final rule that established reporting requirements under the Home Mortgage

Disclosure Act (HMDA), which triggered a full SBREFA review, and the process is likely to follow the same pattern as the HMDA rule.

The SBREFA process will require the CFPB to make available an outline of the regulatory proposals it is considering, along with cost estimates and potential alternative approaches. The CFPB must work with the Small Business Administration's Office of Advocacy and the Office of Management and Budget's Office of Information and Regulatory Affairs to select a cross section of small entity representatives (SERs) from affected industry sectors. These SERs will provide formal comment on the administrative record to the CFPB, at an all-day meeting and in written submissions. The three agencies must then prepare a joint report that responds to the comments provided by the SERs before the CFPB can issue a proposed rule. If the CFPB disregards the small business comments, its action can be determined to be arbitrary and capricious, providing the basis for a successful court challenge to the final rule.

The CFPB's experience with SBREFA panels in the HMDA rule, as well as in recent rulemakings on payday lending and debt collection, illustrates both the significant time and effort the process will require as well as the singular opportunity it affords small business representatives to influence the outcome of CFPB regulatory action. Small lenders active in this marketplace should be taking action now to prepare, in order to maximize their effectiveness in the SBREFA process.

Big-Picture Factors and Implications. Change is in the wind. Will President Trump fire Director Cordray? Will Congress amend Dodd-Frank or find another way to restructure the CFPB? Will the flood of Presidential Executive Orders directing new approaches to rulemaking for financial services regulators and others be held applicable to the CFPB? Questions abound, and the situation could change at any time, but for now, Director Cordray has decreed that for the CFPB it is "business as usual," and parties subject to CFPB regulation, supervision, and enforcement cannot assume otherwise. The CFPB's May 10th field hearing, RFI, and white paper are all familiar signals that a particular financial services sector is next in line for special attention. Those likely to be affected by these developments should move quickly now to assess potential impacts to their businesses and develop effective strategies to optimize desirable outcomes.

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